

ORIGINAL



0000035330

MEMORANDUM

30

TO: Docket Control

FROM: Ernest Johnson  
Director  
Utilities Division

DATE: November 23, 2005 *gler*

RE: STAFF REPORT FOR WATER UTILITY OF GREATER BUCKEYE INC.'S,  
APPLICATION FOR AUTHORITY TO ISSUE DEBT (DOCKET NO. W-  
02451A-05-0615)

Attached is the Staff Report for Water Utility of Greater Buckeye, Inc.'s application for authority to issue debt. Staff recommends conditional approval of a portion of the requested debt authority plus a directive to increase equity in a specific proportion to any debt issuance.

EGJ:CSB:red

Originator: Crystal S. Brown

Attachment: Original and sixteen copies

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2005 NOV 23 P 2:18  
AZ CORP COMMISSION  
DOCUMENT CONTROL

Service List for: Water Utility of Greater Buckeye  
Docket No. W-02451A-05-0615

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**STAFF REPORT  
UTILITIES DIVISION  
ARIZONA CORPORATION COMMISSION**

**WATER UTILITY OF GREATER BUCKEYE, INC.**


**DOCKET NO. W-02451A-05-0615**

**APPLICATION  
FOR AUTHORITY  
TO ISSUE DEBT**

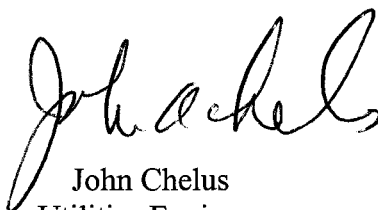
**NOVEMBER 2005**

## STAFF ACKNOWLEDGMENT

The Staff Report for Water Utility of Greater Buckeye, Inc., Docket Number W-02451A-05-0615, was the responsibility of the Staff members listed below. Crystal S. Brown was responsible for the financial review and analysis. John Chelus was responsible for the engineering and technical analysis.



Crystal S. Brown  
Public Utilities Analyst V



John Chelus  
Utilities Engineer

**EXECUTIVE SUMMARY**  
**WATER UTILITY OF GREATER BUCKEYE, INC.**  
**DOCKET NO. W-02451A-05-0615**

Water Utility of Greater Buckeye, Inc. requests authority to issue long-term debt to the Water Infrastructure Financing Authority ("WIFA") in an amount not to exceed \$165,000.

The purpose of the financing is to provide funds for arsenic removal water treatment plant located in Arizona.

Staff recommends approval of the Company's application for authorization to issue long-term debt to the Water Infrastructure Financing Authority ("WIFA") in an amount not to exceed \$114,500 subject to the following condition: that if and when equity falls below 30 percent of total capital the Company be prohibited from distributing more than 25 percent of each year's earnings or distributing assets to principals via salaries, management fees, or otherwise in excess of current levels adjusted for changes in the Consumer Price Index.

Staff further recommends authorizing the Company to issue equity to complement its borrowings to obtain funds for the arsenic removal water treatment plant to the extent that total borrowings and equity issuances do not exceed the total plant cost.

Staff further recommends that the Company issue no less than \$1.00 of equity for each \$2.27 of additional debt.

Staff further recommends that the Commission order the Company to file, as a compliance item in this docket, a plan that is acceptable to Staff, by April 30, 2006, to increase its equity to 40 percent of total capital.

Staff further recommends that the Company be required to file for an increase in permanent rates no later than May 18, 2007, with a 2006 test year, unless the Company can demonstrate to Staff's satisfaction that its times interest earned ratio ("TIER") will increase to 1.0 or greater by December 31, 2006.

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Engineering Memorandum

Affidavit of Publication

### **Introduction and Background**

On August 24, 2005, Water Utility of Greater Buckeye, Inc. ("Buckeye" or "Company") filed an application with the Arizona Corporation Commission ("Commission") requesting authorization to issue debt to the Water Infrastructure Financing Authority ("WIFA") in an amount not to exceed \$165,000.

Buckeye is requesting the financing authorization in order to comply with the United States Environmental Protection Agency's ("EPA") revised drinking water standard for arsenic. The new standard that becomes effective January 23, 2006 reduces the maximum contaminant level from the current 50 parts per billion to 10 parts per billion.

Buckeye is an Arizona Corporation located approximately 37 miles west of Phoenix, in Maricopa County, Arizona. Buckeye charges rates approved in Decision No. 60386, dated August 29, 1997. As of December 31, 2004, Buckeye provided water service to approximately 500 customers.

### **Public Notice**

On October 19, 2005, the Company filed an affidavit of publication verifying public notice of its financing application. The Company published notice of its financing application in *West Valley View* a newspaper of general circulation in Avondale, Buckeye, Goodyear, Litchfield Park and Tolleson, Maricopa County, Arizona on October 18, 2005. Attached is the affidavit of publication.

### **Purpose and Terms of the Proposed Financing**

The purpose of the financing is to provide funds for arsenic removal water treatment plant located in Arizona. Staff examined the construction plans and estimated costs for Buckeye's water treatment project and found them to be reasonable and appropriate as discussed in the attached Engineering Memorandum. The proposed financing is a 20-year amortizing loan at a 5.2 percent interest rate.

### **Financial Analysis**

Staff's analysis is based on Buckeye's adjusted financial statements dated December 31, 2004. Staff accepted only the Company's projections that pertain solely to operation of the arsenic treatment plant for its analysis. The financial analysis shown on Schedule CSB-1 presents selected financial information from the adjusted financial statements and the pro forma effects of two scenarios: (1) a \$165,000 loan and (2) a \$114,550 loan and \$50,500 of equity. Schedule CSB-1 also shows the capital structure and ratios for debt service coverage ("DSC") and times interest earned ("TIER").

### Capital Structure

At December 31, 2004, Buckeye's capital structure consisted of 3.62 percent short-term debt, 67.14 percent long-term debt, and 29.24 percent equity as shown on Schedule CSB-1, column A. The pro forma effect of Buckeye drawing the entire proposed loan of \$165,000 would result in an unsound capital structure comprised of 3.23 percent short-term debt, 83.66 percent long-term debt, and 13.10 percent equity as shown on Schedule CSB-1, column B.

Staff typically recommends that privately owned or investor owned utilities maintain a capital structure consisting of not less than 40.00 percent equity. However, Staff evaluates several factors in making its determination as to an appropriate level of equity in each individual case. These factors include, but are not limited to, the utility's access to capital, current level of debt, age of the system, management's experience, the adequacy of existing or proposed rates, etc. Staff is recommending that Buckeye's equity level of approximately 30 percent not be reduced in the short-term.

The Company could maintain a capital structure with 30 percent equity by financing the construction of the proposed plant with a mix of debt and equity. For example, Staff's recommendation could be achieved by financing the construction with \$50,500 of equity and \$114,500 of debt on a pro rata basis, (i.e., with \$1.00 of equity for each \$2.27 of debt). A \$114,500 loan and a \$50,500 equity infusion results in a pro forma capital structure comprised of 2.74 percent short-term debt, 67.26 percent long-term debt and 30.00 percent equity as shown on Schedule CSB-1 column C. Of course, a mix of funds that uses more than \$50,500 of equity would provide greater financial strength and is preferable. The Company should be encouraged to work toward a capital structure with at least 40 percent equity in the long-term.

### Interest and Debt Service Coverage

Staff also examined the effects of the proposed financing on the Company's TIER and DSC.

DSC represents the number of times internally generated cash (i.e., earnings before interest, income tax, depreciation and amortization expenses) covers required principle and interest payments on debt. A DSC greater than 1.0 means operating cash flow is sufficient to cover debt obligations.

TIER represents the number of times earnings before income tax expense covers interest expense on debt. A TIER greater than 1.0 means that operating income is greater than interest expense. A TIER less than 1.0 is not sustainable in the long term but does not necessarily mean that debt obligations cannot be met in the short term.

Based on the adjusted 2004 financial statements Buckeye's TIER and DSC are <0.11> and 7.77, respectively. Fully drawing the Staff recommended \$114,500 loan increases the pro forma TIER to <0.06> and decreases the DSC to 4.12. The pro forma DSC shows that Buckeye



has adequate cash flow to meet all obligations on the Staff recommended loan. However, the TIER indicates that the Company's income is insufficient to support the proposed loan in the long-term.

### **Conclusions and Recommendations**

Staff concludes that the project the Company proposes to construct is reasonable and appropriate.

Staff concludes that issuance of the entire \$165,000 proposed loan would result in an unsound capital structure.

Staff concludes that that Buckeye would have adequate cash flow to meet all obligations on the recommended \$114,500 debt in the short-term; however, its income is insufficient to service the proposed debt in the long-term.

Staff concludes that the capital structure that would result from a \$114,500 debt issuance and a \$50,500 equity infusion on a pro rata basis is acceptable in the short-term but outside the desirable range for the long-term.

Therefore, Staff recommends authorization for the Company to issue debt to WIFA not to exceed \$114,500.

Staff further recommends authorizing the Company to issue equity to complement its borrowings to obtain funds for the arsenic removal water treatment plant to the extent that total borrowings and equity issuances do not exceed the total plant cost.

Staff further recommends that the Company issue no less than \$1.00 of equity for each \$2.27 of additional debt.

Staff further recommends that if or when equity falls below 30 percent of total capital, the Company be prohibited from distributing more than 25 percent of each year's earnings or distributing assets to principals via salaries, management fees, or otherwise in excess of current levels adjusted for changes in the Consumer Price Index.

Staff further recommends that the Commission order the Company to file, as a compliance item in this docket, a plan that is acceptable to Staff, by April 30, 2006, to increase its equity to 40 percent of total capital.

Staff further recommends that the Company be required to file for an increase in permanent rates no later than May 18, 2007, with a 2006 test year, unless the Company can demonstrate to Staff's satisfaction that its times interest earned ratio ("TIER") will increase to 1.0 or greater by December 31, 2006.

Staff further recommends authorizing the Company to execute any documents necessary to effectuate the authorization granted.

Staff further recommends ordering the Company to docket, as compliance item in this case, copies of all executed financing documents within 60 days after the transactions are completed.

# FINANCIAL ANALYSIS

## Selected Financial Information Pro forma Includes Immediate Effects of the Proposed Long-term Debt

	[A]		[B]		[C]	
	12/31/2004		12/31/2004		12/31/2004	
	With ProForma		With ProForma		With ProForma	
	Operating Expenses		Operating Expenses and		Operating Expenses and	
	Without Loan		Full Amount of Proposed Loan		Staff's Recommended Loan	
			\$165,000		\$114,500	
1	Operating Income	\$ (656)	\$ (656)		\$ (656)	
2	Depreciation & Amortization Expense	\$ 81,537	\$ 81,537		\$ 81,537	
3	Income Tax Expense	\$ -	\$ -		\$ -	
4	Interest Expense on Debt	\$ 5,871	\$ 14,337 (a)		\$ 11,746 (a)	
5	Repayment of Principal	\$ 4,540	\$ 9,361		\$ 7,885	
<b>TIER</b>						
6	[1+3] + [4]	(0.11)	(0.05)		(0.06)	
<b>DSC</b>						
7	[1+2+3] + [4+5]	7.77	3.41		4.12	
8	Short-term Debt	\$ 4,848 3.62%	\$ 9,669 (b) 3.23%		\$ 8,194 (c) 2.74%	
9	Long-term Debt	\$ 89,920 67.14%	\$ 250,099 (d) 83.66%		\$ 201,074 (e) 67.26%	
10	Equity	\$ 39,170 29.24%	\$ 39,170 13.10%		\$ 89,670 (f) 30.00%	
11	Total Capital	\$ 133,938 100.00%	\$ 298,938 100.00%		\$ 298,938 100.00%	
			\$ 165,000		\$ 165,000	

(a) The pro forma interest expense was annualized by multiplying the projected balances of existing debt (as of 12/31/04) by their stated interest rates and includes the first year of interest on the entire proposed loan.

(b) Includes \$0 in short-term debt and \$4,821 in projected current maturities on \$165,000 long-term debt as 12/31/04.

(c) Includes \$0 in short-term debt and \$3,345 in projected current maturities on \$114,500 long-term debt as 12/31/04.

(d) Includes \$89,920 in existing long-term debt and \$160,179 in proposed long-term debt (i.e. \$165,000 - \$4,821 in current maturities on proposed debt).


(e) Includes \$89,920 in existing long-term debt and \$111,155 in recommended long-term debt (i.e. \$114,500 - \$3,345 in current maturities on recommended debt).

(f) Includes \$39,170 in existing equity as of 12/31/04 and \$50,500 in additional equity needed to construct plant.

## MEMORANDUM

DATE: November 2, 2005

TO: Crystal Brown  
Public Utilities Analyst V  
Utilities Division

FROM: John A. Chelus   
Utilities Engineer  
Utilities Division

RE: Water Utility of Greater Buckeye, Inc.  
Docket No. W-02451A-05-0615 (Financing)

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### **Introduction**

The Water Utility of Greater Buckeye, Inc. ("Company") has submitted a financing application to fund the installation of arsenic treatment systems totaling \$165,000 in long term indebtedness with the Water Infrastructure Financing Authority ("WIFA"). The Company operates a water system in and around the Town of Buckeye, in Maricopa County.

### **Existing Water System**

According to the Company's 2004 Annual Report, the water system consists of five wells (producing a total 560 gallons per minute), ten storage tanks (totaling 599,000 gallons) and a distribution system serving 501 service connections. The arsenic concentrations reported from the well sources range from 7 parts per billion ("ppb") to 14 ppb.

### **Financing Application**

The Company is requesting WIFA financing approval in the amount of \$165,000 for arsenic treatment systems needed for two current operating well sites. The well sites that require treatment are listed below with their arsenic levels:

<u>Well</u>	<u>Arsenic Level</u>
1. Well ADWR #55-802333 (Sweetwater II)	12 ppb
2. Well ADWR #55-572657 (Sonoran Ridge)	14 ppb

The Company plans to install arsenic treatment systems with the financing request as follows:

1.	Design & Engineering – Permits	\$ 22,000
2.	Legal/Debt Authorization	\$ 5,000
3.	Equipment/Materials	\$121,839
4.	Construction/Installation/Improvement	\$ 6,412
5.	Contingency	\$ 9,749
		-----
Total cost:		\$165,000

The Company plans to install FlexSorb Modular Sorption Systems as water treatment systems that uses ArsenX media to remove arsenic. ArsenX is a new hybrid arsenic removal media that utilizes nano-particle technology to combine iron chemistry and plastic bead durability. The system supplier will be Mobile Process Technology.

#### Arsenic Treatment - Alternatives Considered

The Company researched and evaluated four treatment alternatives for arsenic removal; 1) reverse osmosis, 2) ion exchange, 3) adsorbent removal, and 4) coagulation/filtration. Due to restrictions of land size, sewer capacity and waste stream handling, the ion exchange and reverse osmosis treatment methods were rejected. Once the iron-based adsorbent method of treatment was decided upon, further research and field trials were investigated. At the end of the trial runs, the ArsenX media was selected based on its regenerative properties, ease of use and fairly economical capital cost for initial installation.

#### Pilot Testing

A full scale unit of the FlexSorb Modular Sorption System is scheduled to be installed by October 21, 2005, for further testing and as required by Maricopa County Environmental Services Department ("MCESD").

#### **MCESD Compliance**

The MCESD reported no system deficiencies and has determined the water system is currently delivering water that meets water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.

#### **Conclusion**

Staff concludes that the arsenic treatment systems totaling \$165,000 is appropriate and the cost estimate presented herein is reasonable for purposes of this financing request. However, no "used and useful" determination of the proposed project item was made and no particular treatment should be inferred for rate making or rate base purposes in the future.

ORIGINAL

**Water Utility of Greater Buckeye, Inc.**

3800 N. Central Ave. Ste. 770

Phoenix, AZ 85012

Phone 602-224-0711, Fax 602-224-5455

**RE: Docket No. W-02451A-05-0615**

**Water Utility of Greater Buckeye Finance Application**

October 19, 2005

Utilities Division

Arizona Corporation Commission

1200 W. Washington St.

Phoenix, AZ 85007

To Whom It May Concern:

The attached notice was published on October 18, 2005 in the West Valley View Newspaper that circulates in Water Utility of Greater Buckeye's service area. The Affidavit of Publication from the West Valley View Newspaper is attached.

Sincerely,



John Mihlik, Jr.

CFO

Attachment: Copy of Notice and newspaper Affidavit of Publication

STATE OF ARIZONA            )  
  ) ss.  
COUNTY OF MARICOPA    )

SUBSCRIBED AND SWORN before me this 19<sup>th</sup> day of October, 2005, by John Mihlik, Jr., CFO of Water Utility of Greater Buckeye, Inc.



**JILL KARPINSKI**  
Notary Public - Arizona  
Maricopa County  
Expires 04/15/08

  
\_\_\_\_\_  
Notary Public

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Packet # W-02451A-05-0615

# WEST VALLEY VIEW

200 W. Wigwam Blvd., Litchfield Park, Az. 85340-4636 • (623) 535-VIEW [535-8439]

## AFFIDAVIT OF PUBLICATION

State of Arizona

County of Maricopa

I, Elliott Freireich, publisher of West Valley View newspaper of general circulation in Avondale, Buckeye, Goodyear, Litchfield Park and Tolleson, Arizona, attest that the advertisements for

Water Utility of Greater Buckeye, Inc. - Ref.  
Curtis, Goodwin, Sullivan, Udall, & Schwab, PLLC  
Public Notice - Application for an Order Authorizing the issuance of Debt

will be / has been published on October 18, 2005.

Elliott Freireich  
Elliott Freireich, Publisher

October 18, 2005.  
Date

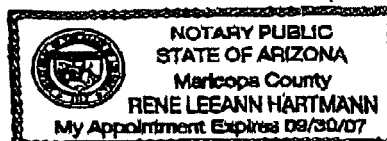
SUBSCRIBED AND SWORN TO BEFORE ME ON THE

18 DAY OF October (Month), 2005 (YEAR)

NOTARY SIGNATURE

Rene Leeann Hartmann

**COPY**



Docket # W-02451A-05-0615

### Public Notice

AN APPLICATION FOR AN  
ORDER  
AUTHORIZING THE ISSUANCE  
OF DEBT

BY WATER UTILITY OF  
GREATER BUCKEYE, INC.  
Water Utility of Greater  
Buckeye, Inc. (Applicant) filed  
an Application with the Arizona  
Corporation Commission  
(Commission) for an order  
authorizing Applicant to issue  
\$165,000 in debt to make  
improvements to its water  
system to reduce the arsenic  
level. The application is available  
for inspection during regular  
business hours at the office of the  
Commission in Phoenix, Arizona,  
and the Company's offices in  
Phoenix and Buckeye, Arizona.

Intervention in the  
Commission's proceedings on  
the application shall be permitted  
to any person entitled by law to  
intervene and having a direct  
substantial interest in this matter.  
Persons desiring to intervene  
must file a Motion to Intervene  
and thirteen copies, with the  
Commission's Docket Control at  
1200 West Washington, Phoenix,  
Arizona and serve a copy upon  
the Applicant c/o William Sullivan,  
Curtis, Goodwin, Sullivan, Udall  
& Schwab, P.L.C., 2712 North  
7<sup>th</sup> Street, Phoenix, Arizona  
85006. The Motion to Intervene  
at a minimum, shall contain the  
following information:

1. The name, address and  
telephone number of the  
proposed intervenor and of any  
person upon whom service  
of documents is to be made if  
different than the intervenor.

2. A short statement of the  
proposed intervenor's interest in  
the proceeding.

3. Whether the proposed  
intervenor desires a formal  
evidentiary hearing on the  
application and the reasons for  
such a hearing.

4. A statement certifying that  
a copy of the Motion to Intervene  
has been mailed to Applicant.

The granting of Motions to  
Intervene shall be governed by  
A.A.C. R14-3-105, except that all  
Motions to Intervene must be filed  
on, or before, the 15th day after  
the date this notice is published.

Published in the West Valley  
View, and the West Valley  
Business, on October 18, 2005.